Rabobank

Economic Update United Kingdom

2 October 2012

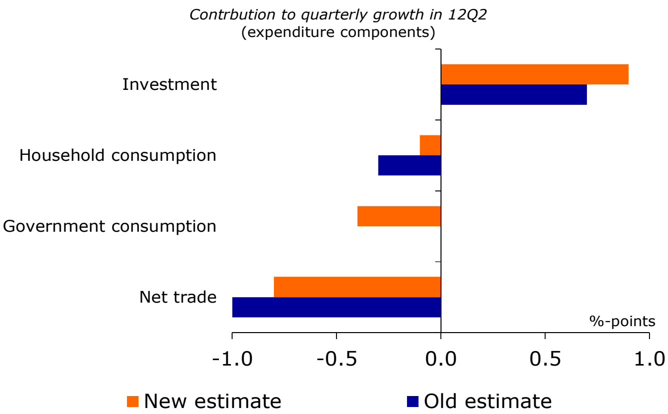
Every silver lining has a cloud

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	0.8	-¼	1¼
Private consumption	-1.0	½	1¾
Government expenditure	-1.2	-¼	-2
Private investment	1.1	4½	3
Exports	4.4	½	4½
Imports	0.5	2	4¼
Inflation	4.5	2½	2
Unemployment (%)	8,2	8¼	8¼
Government balance (% GDP)	-8.5	-8	-6½
Government debt (% GDP)	82.5	88¼	91½

Source: Reuters EcoWin, Rabobank

- UK GDP was revised further upwards in 12Q2.
- A number of indicators are pointing to a stronger pace of recovery. Most importantly, August PMI surveys came in much stronger than expected and the labour market miracle continues unabated.
- That said, the Olympics and the reversal of working day effects in June may be distorting the data. Moreover, some other indicators are still pointing to a weak recovery. Therefore, it makes sense to wait for the autumn data to draw a more definitive judgement on the underlying strength of the economy.
- Banks' willingness to increase credit availability for households is seen as positive.

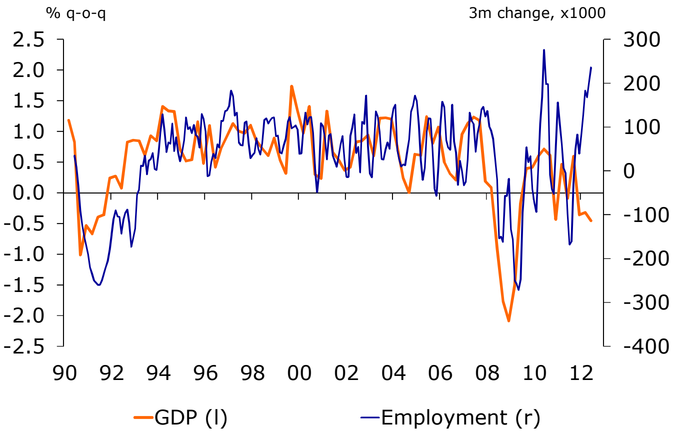
GDP revised further upwards in 12Q2, as expected



Source: ONS

The National Accounts published last week showed that UK GDP decreased 0.4% q-o-q in 12Q2. Since the preliminary estimate, Q2 GDP has been revised up by 0.3%-points from a fall of 0.7%. The breakdown has altered slightly. Household consumption remained weak despite an upward revision. These figures match consumer confidence surveys, which remain at depressed levels (see below). Government spending is now estimated to have fallen, whereas business investment is thought to have risen more strongly. Meanwhile, net trade is still estimated to have been a big drag on growth. We expect the 'final' estimate (released in 2014) to be revised further upwards.

The labour market still surprising on the upside …



Source: Reuters EcoWin

The UK economy is recently showing some signs of life. As a result, some have been quick to conclude that the "green shoots" of recovery are re-emerging. Most notably, the labour market miracle continues unabated. Employment rose by 236,000 in the three months to July. The rise in the jobless rate from 8.0% to 8.1% between July and August was thanks to a pickup in labour force participation. The puzzle of a shrinking economy combined with a buoyant labour market is partly due to the Olympics. Around 91,000 of the new jobs that were created in the three months to July were in London – 38.5% of the total – despite the fact that the capital accounts for about 13% of overall employment.

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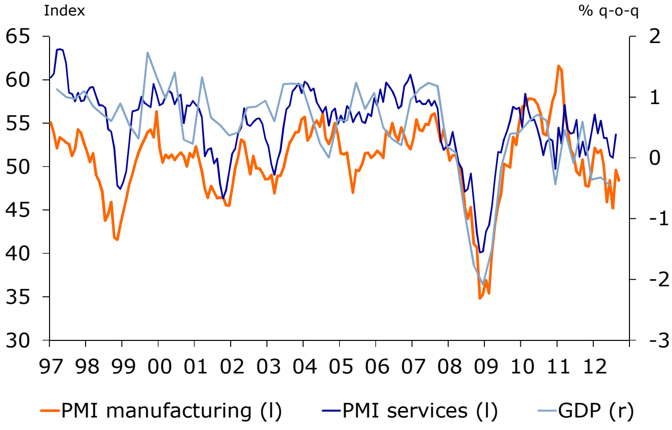
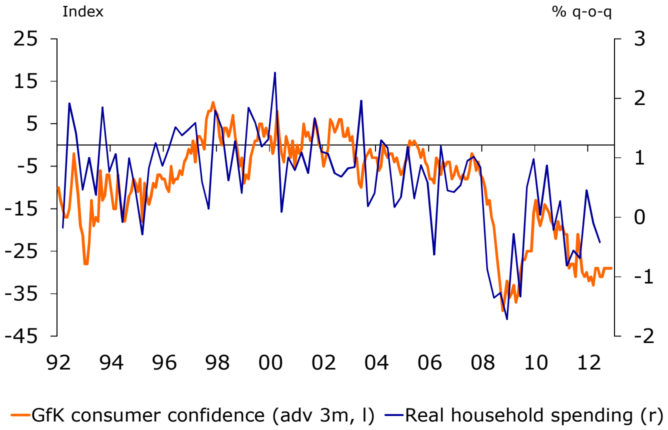
… as are some other reliable indicators …



Source: Reuters EcoWin

Thankfully, the good news does not stop there. Manufacturing output rose 3.2% m-o-m in July, reversing the Jubilee-distorted 2.9% decline in June (there were two fewer working days). What's more, producer sentiment improved significantly. The manufacturing PMI rose from 45.2 in July to 48.4 in September while the services PMI increased from 51.0 in July to 53.7 in August. Finally, July's trade numbers proved to be much better than the consensus had expected. The trade deficit shrank from GBP 4.3bn in June to GBP 1.5bn, thanks largely to a near 8% monthly increase in goods exports (volume). Of course, this largely reflected a recovery from June's 6.6% fall.

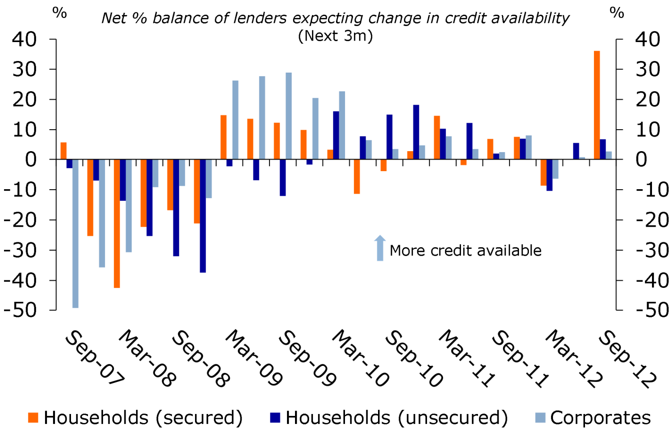
… but good things come to those who wait



Source: Reuters EcoWin

Before we get ahead of ourselves we must note that the Olympics and the reversal of working day effects in June may be distorting the data. Moreover, survey data tend to be more volatile over the summer months because survey returns are lower than average. Not to mention that there are some data that point to weaker activity. Consumer confidence has barely improved, tax receipts have been disappointing recently and retail sales remained flat between June and August. Overall, there are some positive signs that cannot be ignored but we need to wait for the autumn data to draw a more definitive judgement on the underlying strength of the economy.

Will credit start flowing again?



Source: Reuters EcoWin

The 12Q3 credit conditions survey suggested that lenders are responding positively to the *Funding for Lending Scheme*, which involves the Bank of England providing funding to banks for a period of 4 years at rates below existing market rates. The survey shows that would-be home buyers benefit the most. But even if banks are willing to increase credit availability, households may still be unwilling to borrow while repairing their balance sheets. Poor economic visibility and a weak housing market are extra deterrants for raising leverage. And we must stress that the survey painted a less rosy picture regarding corporate lending. As a result, credit-starved small businesses will not benefit as much.

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